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## COMMENT

August 4, 1998

### FEDERAL EXPRESS

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Division of Trading and Markets  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW, 4th Floor  
Washington, D.C. 20581

Re: Application of Cantor Financial Futures  
Exchange for Designation as a Contract  
Market in U.S. Treasury Bond, Ten-Year  
Note, Five-Year Note, and Two-Year Note  
Futures Contracts  
Our File No.: 316.1

Dear David:

As a result of our continuing discussions with you and other members of the Commission's staff, additional information has been requested. The following responses are provided in the order in which issues were raised by the Commission's staff.

1. Clearing Time. All references to the concept of "Clearing Time" in the Rules have been deleted. We understand that the Commission would treat any future request by CFFE to re-instate Clearing Time as an application pursuant to paragraph (c) of Commission Regulation § 1.41.

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2. Public Board Members. CFFE Rule 35 has been revised to clarify that employees of any of Cantor Fitzgerald's affiliates and members of the Board of Trade of the City of New York, Inc. ("NYBT") and its affiliates and subsidiaries are excluded from serving as Public Board Members for CFFE. See Exhibit 1.

3. Transaction Fees. The Transaction Fees for Contracts traded on CFFE will likely be different from the fees currently charged by Cantor Fitzgerald in its cash business because both markets have distinct characteristics.

4. Guarantee Agreements. Copies of the Clearing Member Guaranty Agreements (Forms A and B) are attached hereto as Exhibit 2.

5. Terminal Operator Tapes. The tapes containing conversations of Terminal Operators will be recorded and then stored for a period of 120 calendar days in secured and locked rooms at Cantor Fitzgerald's trading facilities. Only a limited number of authorized persons, who will be approved by the Director of either the Compliance Department or the Market Surveillance Department of NYBT and who will act as "agents" of CFFE in accordance with (new) Rule 301-A, will control access to such rooms. If, for example, a Terminal Operator wishes to listen to a taped conversation to resolve a dispute with a customer, he or she will first have to obtain authorization by his or her supervisor. The Terminal Operator will then be granted access to a "dupe" tape (not the "master tape" which remains untouched) by an authorized person who will assist the Terminal Operator and remain present in the recording room as long as the Terminal Operator is there. NYBT's Compliance and Market Surveillance staff will have access to the tapes and will be considered authorized to listen to said tapes. The tapes will be available for the staff's use as needed in connection with NYBT's regulatory responsibilities. If necessary, the staff may keep tapes beyond the 120-day period referred to above. In addition to the recordings, the staff will have the ability to listen in to the Terminal Operators' conversations on a "live" basis, and will also have its own office (equipped with a Terminal Operator terminal) on Cantor Fitzgerald's premises.

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6. Organizational Chart. Attached hereto as Exhibit 3 is an updated organizational chart including CF Account Managers LLC, the Cantor Fitzgerald entity that will manage the error account.

7. Role and Function of Terminal Operators. A Terminal Operator:

(a) may accept orders from Authorized Traders, enter such orders into the Cantor System and report trade executions back to Authorized Traders;

(b) may provide publicly available information (whether such information has been solicited or not) including with respect to CFFE and Contracts traded on CFFE to Authorized Traders and Screen Based Traders (such as, for example, information with respect to the aggregate amount of orders resting in the Cantor System and trade executions); and

(c) may solicit orders with respect to Contracts handled by him or her and engage in marketing with respect to CFFE; but

(d) may not provide any advice (whether written, oral or in any other form) with respect to trading on CFFE generally or in any Contract in particular to any Authorized Trader or Screen Based Trader or any customer of such Authorized Trader or Screen Based Trader.

The foregoing prohibition is codified in new Rule 712-A (see Exhibit 1) and will be subject to supervision and enforcement by NYBT's Compliance and Market Surveillance staff. In light of this new Rule, which describes in detail the role and responsibilities of Terminal Operators, there is no need to prepare and submit a Terminal Operator Manual at this time. Therefore, all references to such manual in prior submissions should be deemed removed from the record.

8. System Shutdown. In the event of an unexpected shutdown of the Cantor System during the trading day, all matched trades not previously reported to Commodity Clearing Corporation ("CCC") will subsequently be forwarded upon reactivation of the system. By contrast, any unmatched bids or offers that were resting in the

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Cantor System at the time of the shutdown will be automatically canceled.

9. Surveillance and Compliance. NYBT's Compliance and Market Surveillance staff will be present every Business Day at Cantor Fitzgerald's trading facilities for the purpose of carrying out its regulatory responsibilities with respect to CFFE. To the extent practicable and subject to trading activity, one member of such staff will initially be present for one hour at the opening of trading (presently at 7:30 a.m.), one-half hour during the settlement price computation (presently at 3:00 p.m.), one-half hour at the close of trading (presently at 5:30 p.m.) and one additional hour at any time during the trading day, such time to be determined by a senior member of NYCE's Compliance and Market Surveillance staff.

10. Joining of Bids and Offers. Each new best bid or offer with respect to a Contract must be for a minimum of ten such Contracts. Once a bid or offer for at least ten Contracts is entered into the Cantor System, joining bids or offers will be permitted for at least one such Contract. Joining bids or offers for less than ten Contracts will be permitted to stay in the Cantor System and will continue to be posted even if the initial bid or offer is canceled or hit or lifted, as the case may be. If the trader who posted the initial bid or offer decides to change such bid or offer, the changed bid or offer is treated like a new bid or offer (i.e., it has to be for a minimum of ten Contracts). An "aggressor" who wishes to hit a bid or lift an offer is generally subject to the same minimum size requirements (including the exceptions) as described in the foregoing sentences; however, the first "aggressor" may hit a bid or lift an offer for less than ten Contracts if only such lesser quantity is available. It should be noted that all bids and offers for at least one Contract are permitted in connection with a Market Crossing.

11. Board of Directors. The Not-for-Profit Corporation Law ("NPCL") in effect in the State of New York, which governs all organizational matters of CFFE, affords corporations considerable flexibility with respect to internal procedures and structures. The general rule that "directors shall be elected by a plurality of votes cast at a meeting of members by the members entitled to vote

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in the election" (see NPCL § 613(a)) is expressly made subject to divergent provisions in the certificate of incorporation or by-laws of the corporation in question. More specifically, NPCL § 703(b) states that: "Directors shall be elected or appointed in the manner and for the term of office provided in the certificate of incorporation or the by-laws." It is against this background that CFFE By-Law Section 1 provides for the appointment of certain directors by NYCE and Cantor Fitzgerald, respectively, as the entities who have entered into the Cantor Financial Futures Exchange Agreement to form CFFE. Attached hereto as Exhibit 4 are copies of NPCL § 613(a) and 703(b).

12. Organizational Documents. We provided you with copies of the Articles of Organization of CFFE Regulatory Services, LLC and the Certificate of Incorporation of Cantor Financial Futures Exchange, Inc. on July 24, 1998.

13. Disclosure and Trading Prohibitions. In response to certain concerns that the disclosure and trading prohibitions of (old) Rule 712 might not cover all potential abuses of material non-public information, we have revised and broadened the scope of such Rule. In this connection, we have introduced the concept of "CFFE Insider" in new CFFE Rule 11-A. See Exhibit 1.

14. Customer Terminal Operators. An Authorized Trader who wishes to place a customer, as opposed to a proprietary, order on CFFE will have to call a Terminal Operator who is specifically designated to handle such customer orders. Such designated Terminal Operator will initially input only such information into the Cantor System as is required to be input by all Terminal Operators (i.e., identification of Clearing Member or Screen Based Trader, Contract, size and price). At the same time, the Terminal Operator will note a unique account identifier for the Authorized Trader's customer manually, on a customer order sheet kept by such Terminal Operator. Upon checkout, that is a few minutes after execution of the relevant trade, the Terminal Operator will enter the account identifier that was noted on the customer order sheet into the Cantor System. This two-step procedure ensures that the ultimate customer, as well as the Authorized Trader calling on behalf of such customer, will not be disadvantaged by any delay in the order-entry procedure. Any errors will be resolved by matching

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the information in the Cantor System against the Terminal Operator tapes and the customer order sheets. NYBT's Compliance and Market Surveillance staff will monitor and audit the handling of customer orders in accordance with the protocol described under 15. below.

15. Compliance Procedures. NYBT's Compliance Procedures relating to Daily Data, Reports, Audit Trails and Floor Surveillance are as follows:

(a) Daily Data, Reports:

The Data Entry Transaction Log, the Transaction Log, Changes to the Executed Transaction Log, and the compliance computer reports that utilize trading data will be produced, available and reviewed on a daily basis by the compliance staff. "Daily basis" does not mean each day; for example, five days of reports may be reviewed on one day. Therefore, each day's data will be reviewed.

The compliance program will focus on areas of trading violations; e.g. trading ahead, preferential trading, pre-arranged trading etc. The Trading Ahead Exception Report will focus upon Clearing Members (rather than floor brokers) and will use a "transaction" parameter (rather than a time parameter). The Concentration of Trading Report will focus upon the percentage of trading between unique account IDs. (This report can be used for targeting possible pre-arranged trading.)

The compliance staff will utilize a Trading Ahead Summary Report showing the number of "hits" or exceptions which they will review daily. The summary reports will be produced on a daily basis and will provide weekly, bi-weekly and monthly statistics.

(b) Audit Trail Reviews:

Audit Trail Reviews will be conducted on a monthly basis. Through the course of a year, all Terminal Operators/CFFE Terminals will be reviewed. In order to achieve this,

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each month a number of Terminal Operators will be randomly selected for review. The selection will probably be for ¼ hour periods. The same ¼ hour period for each Terminal Operator will be selected in one review (if this can provide a good "cross-section", otherwise, different ¼ hour periods might be selected). The ¼ hour time frame will vary from month to month (e.g., one month might cover 11:00-11:29 a.m. while another month might cover 13:30-13:59 p.m.). For the review, the ¼ hour tape for the relevant Terminal Operator will be matched against the Data Entry Transaction Log and/or the Transaction Log. For those Clearing Members who are placing orders for customers, the order tickets will be requested and matched to the Terminal Operator tape, the Terminal Operator's customer order sheet, the Data Entry Transaction Log and the Transaction Log. Each Terminal Operator's customer order sheets will be sequentially numbered and will be retained as an exchange record.

(c) Floor Surveillance:

NYBT's Compliance and Market Surveillance staff will have an office on the premises. Staff will be present on each Business Day to physically monitor the trading areas and to listen to tapes and live conversations.

A copy of the Compliance Procedures which were previously submitted to the Commission is attached hereto as Exhibit 5.

16. System Clock. The clock built into the Cantor System is re-set each day to be synchronized with the National Institute of Standards and Technology's atomic clock.

17. Appeal Procedures. Other than for limited situations regarding summary action proceedings, NYCE does not have an appeals procedure for disciplinary cases. If a respondent wishes to appeal a disciplinary decision, he or she must appeal directly to the Commission.

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18. Public Board Member. Rule 26 has been revised to change the defined term "Public Director" to "Public Board Member" to be consistent with Rule 36. See Exhibit 1.

19. Cotton Floor Committee. By-Law Section 14 has been revised to change the name of the Committee on Recordkeeping to "Cotton Floor Committee". See Exhibit 1.

20. Trading Prohibition Exemptions. Rule 712(b) has been revised to vest the exemptive authority with respect to the trading prohibition in NYCE's Executive Committee, rather than in CFFE's Executive Committee. See Exhibit 1.

21. President. By-Law Sections 1 and 12 have been revised to provide that the President of CFFE shall be the Executive Vice-President, President of Financial Products of NYBT. In addition, By-Law Section 15 has been revised to remove the reference to "ex-officio" regarding the President. See Exhibit 1.

22. Floor Broker Registration. CFFE agreed to register all Terminal Operators as floor brokers with the National Futures Association ("NFA") in order to address concerns that the Terminal Operators, who perform services for CFFE on a regular basis, should be directly subject to the jurisdiction and supervision of the Commission. Obviously, the role and function of Terminal Operators is substantially different from that assigned to floor brokers under the Commodity Exchange Act. The floor broker category was chosen merely because other categories of registered persons appeared even less suited to the particular circumstances of this electronic marketplace. Applications for all Terminal Operators have been submitted to the NFA and are being processed subject to the designation of CFFE as a contract market.

23. Y2K Policies. NYBT's and Cantor Fitzgerald's respective Year 2000 policies were submitted as Appendices to our May 1998 responses to the Commission. Please advise us with respect to which areas you require further clarification.

24. Position Limits. The Rules regarding the Two-Year U.S. Treasury Securities Futures Contract have been amended to provide for position limits. See Exhibit 6. Also, we have added new Rules



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200 through 202 authorizing position limits and providing for exemptions therefrom. See Exhibit 1.

25. Revised CFFE By-Laws and Rules. Attached hereto as Exhibit 1 are a blacklined and an unmarked copy of the revised By-Laws and Rules of CFFE.

26. Commission Jurisdiction. In order to clarify the status of certain Cantor Fitzgerald employees with respect to CFFE, we have added Rule 301-A, which states that such persons are "agents" of CFFE for purposes of CEA § 2(a)(1)(A)(iii). See Exhibit 1.

27. System Audit. The general audit performed by Deloitte & Touche LLP for Cantor Fitzgerald on a yearly basis (see Item 11 in our answers to the Security and System Vulnerability Questionnaire dated June 22, 1998) covers certain of Cantor Fitzgerald's systems, but not the proprietary order entry system referred to as the "Cantor System" in the By-Laws and Rules of CFFE.

28. Arbitration Rules. NYCE's Consolidated Rules, which are incorporated into CFFE's Rules by reference, have been revised as follows:

(a) Rule 8.00 now includes a reference to CFFE's employees and agents;

(b) Rule 8.01(a)(3) now includes references to both Rules 723 and 724 of CFFE, as well as to CFFE's employees and agents; and

(c) Rule 8.04(a) has been revised to extend the period of limitations for controversies relating to CFFE to 120 days, which corresponds to the time period during which the Terminal Operator tapes will be retained (see under 5 above). See Exhibit 7.

29. Contract Specifications. We have removed all references to the New York Board of Clearing, Inc. from the Rules containing the specifications for the four Contracts that will initially be traded on CFFE. All transactions conducted on CFFE will be cleared through the CCC. See Exhibit 6.

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30. Associate Member' Trading Privileges. By-Law Section 35-A provides that, absent registration in an appropriate capacity with the NFA, Associate members may place orders only for their proprietary accounts. In the interest of clarity, this concept has been incorporated in Rule 32. See Exhibit 1.

31. Authorized Trader and Screen Based Trader. We have revised the definitions of "Authorized Trader" and "Screen Based Trader" in the Rules, as well as the corresponding By-Law Section 36 and Rule 101 relating to Trading Privileges, in order to frame the respective roles and functions of the persons and entities referred to in a consistent and unambiguous manner. See Exhibit 1.

32. Financial Requirements. We have revised Rule 101(d) to remove the net worth requirement for Clearing Members and Screen Based Traders because such requirement is unique to NYCE's Rules and is not required under the Rules of the Coffee, Sugar & Cocoa Exchange, Inc. The financial requirements for Clearing Members in the Rules of the CCC remain unchanged. See Exhibit 1.

33. Disciplinary Committee. We have deleted the reference to CFFE's Board of Directors being an Exchange Disciplinary Committee within the meaning of Rule 501(a)(3). See Exhibit 1.

34. Information on Authorized Traders. Terminal Operators will be provided with a list of Authorized Traders for the several Clearing Members and Screen Based Traders, and will be able to contact such Authorized Traders in one or more of the following ways: through a dedicated phone line, by using a speed-dial button or by dialing the phone number contained in the list.

Thank you for your continued assistance and cooperation.

Very truly yours,

*David P. VanWagner* 

MRK:ms

Enc.

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